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March 19, 1956

SUMMARY REPORT AND RECOMMENDATIONSI. General Conclusions on Communist Chinese Trade From Previous CFEP Papers

- A. The continued posture of aggression deliberately assumed by Communist China warrants the continued application against that regime of all feasible economic and political pressures by the Free World.
- B. The differential controls exert significant pressures against Communist China. Economic pressures include the denial to the regime of Free World goods and services except to the extent that diversion and transshipment of Free World goods occur, and additional transportation and other costs to Communist China involved in the procurement of such goods. Political pressures comprise those flowing from enhanced cohesion of Free World nations in their opposition to Communist Chinese aggression and subversion, impairment of Communist Chinese prestige and political capacities, and probable stresses and strains on the ties between Communist China and its Soviet partners.
- C. Reduction of the differential controls under conditions prevailing today might have an adverse effect upon the position and prestige of the U. S. in the Far East, as well as the prestige of SEATO and similar organizations, and might adversely affect U. S. public opinion, including congressional opinion.
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cl C. Reduction of the differential controls under conditions prevailing today would be untimely and especially damaging to Free World interests. It would significantly impair the position and prestige of the U. S. in the Far East, as well as the prestige of SEATO and similar organizations. It would adversely affect U. S. public opinion, including congressional opinion. 7 1/

1/ Defense recommends inclusion of the bracketed paragraph in place of the paragraph preceding it.

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D. The military potential of Communist China is severely limited by its primitive industrial economy and by serious deficiencies in transport and other services essential to both economic growth and military expansion. The Communist regime can meet its ambitious plans and programs only by substantially increasing its imports, either from the Bloc or from the Free World. ~~The Communist regime can meet its ambitious plans and programs only by maintaining its present level of imports from the Bloc or by increasing its present level of imports from the Free World.~~ ^{The order of however} ^{The Communist regime can meet its} ^{ambitious plans and programs only by maintaining its present level of} ^{imports from the Bloc or by increasing its present level of imports from the Free World.} ^{1/} The European Bloc is the principal source of essential imports, in keeping with the basic Sino-Soviet Bloc policy of self-sufficiency.

E. The inability of Communist China further to increase its exports significantly, together with the trade and financial controls of the Free World, greatly limit the regime's ability to acquire imports from the Free World.

II. United Kingdom Proposals

The United Kingdom, both in their Aide Memoire of January 3, 1956 and in the Eden-Eisenhower discussions, presented a priority list of items which they nominated for progressive decontrol over a six months period. It was made clear in the Aide Memoire that their basic objective remains the elimination of the entire differential within one year. They also have included in their priority lists 21 COCOM List II and List III items, but it is not clear whether they propose completely to decontrol these items or to retain them on the CHINCOM lists for control identical to that applied on the COCOM list.

1/ CIA recommends the inclusion of the bracketed portion in place of the sentence preceding it.

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Careful analysis of the United Kingdom proposals demonstrates that even their minimum proposal constitutes a sweeping revision and reduction in substance of the CHINCOM controls. It is probable that agreement to that priority list would, in fact, eliminate important parts of the functional groups of commodities and would so weaken the remaining items that their retention for an extended period would be unlikely.

The United Kingdom indicated at one time that they would go forward unilaterally to decontrol the differential items if the United States would not support them in CHINCOM in a substantial relaxation. It is not clear, however, that they would, in fact, take this unilateral and extreme step.

III. Japanese Proposals

The Japanese have made three proposals for deletion. Last October, they submitted a list of 111 items which they wished the United States to consider bilaterally for decontrol. After informal discussion between the two governments, the Japanese submitted in November a list of 11 items (actually eight item listings) which they considered urgent, and for shipments of which they wished, with United States support, immediately to request specific exceptions by the China Committee. In further discussions with the Japanese, we indicated that we could not agree to immediate action on their request but were still considering their lists and would appreciate additional justification by them for their proposals. Late in February, they substituted, for their October list, a third list (with accompanying justification), totalling approximately 130 items, divided between those which they considered first priority and second priority. 26 of these items appear on IL-II and IL-III.

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Except for the short list of 11, the Japanese proposals were sufficiently broad as to have a large impact on the differential lists and to weaken the controls in nearly every sector.

The Japanese have indicated that they, like the British, have as their objective the complete elimination of the differential. However, they also appreciate the U. S. attitude and problems and are willing not to press for realization of this objective at this time, provided they can obtain substantial reductions in the differential to accommodate their internal political and commercial pressures. The delay in obtaining these reductions has been such that they have recently renewed their request for support of exceptions involving the eleven items as interim relief with special emphasis on wooden fishing vessels and hulls therefor, and automotive replacement parts. Through agreement in the EDAC structure, the Secretary of State has been authorized to inform the Japanese, at a time calculated to obtain the best return to the U. S., that the U. S. would be sympathetic to a Japanese exception request in CHINCOM regarding the wooden fishing vessels, subject, of course, to quantities, quid pro quo, etc.

IV. Analysis of Trade Prospects and Strategic-Economic Effects

Annex B (Revised) estimates that the increase in Free World exports resulting from elimination of the China differential would be very slight in the aggregate, and would be distributed so that no one country would benefit significantly with the exception of Japan, which might increase its total exports by approximately three percent. The gain to the Communist Chinese economy would be by a resultant

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reduction in the cost of her imports and by the wider range of goods available from which she would select imports most advantageous to improving her industrial situation. There might well be a change in the pattern of imports in that Communist China would concentrate on items now on the CHINCOM Control Lists and reduce imports which she now obtains from the Free World.

Notwithstanding the conclusion that the elimination of the China differential would be to the net disadvantage of the Free World, it is evident that there is, and will continue to be, substantial pressure by the CG governments on the U. S. to agree to a substantial reduction in the control lists affecting Communist China. This pressure appears to stem largely from internal political factors rather than from any illusion by governments as to the large amount of trade which might develop.

V. Basic Considerations

The following basic considerations have been agreed as background for dealing with the current issue.

1. The maintenance of meaningful CHINCOM controls is important to current U. S. foreign policy.
2. From the strategic and the U. S. domestic political points of view, no substantial reduction in CHINCOM controls should occur at this time.
3. From an economic standpoint, it is only with respect to Japan -- and then only to a moderate degree -- that it can be estimated that a relaxation of CHINCOM controls would result in an expansion of a Free World country's foreign trade significant in proportion to the present total of such trade.

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4. Both political and commercial pressures are nevertheless being exerted on participating governments to achieve relaxation of CHINCOM controls; in light of these pressures, the U. S. would be warranted in concurring in some relaxation in CHINCOM controls provided that

- (a) a substantial CHINCOM differential control is retained,
- (b) the CHINCOM control system is increased in effectiveness, and
- (c) the over-all CG/COCOM/CHINCOM activity is materially strengthened to the extent determined by the U. S. Government to be practicable.

5. Negotiations, both bilateral and CG/CHINCOM, should be conducted in such manner as to assure a reasonable degree of relief for Japan and some participation in trade by the other PC's without appearing to show any obvious preference for any participating country. Other bilaterals should be scheduled so as not to emphasize the U. S.-U. K. bilaterals.

VI. U. S. Negotiating Objectives

At a forthcoming CG meeting at which a review of the CHINCOM controls will be scheduled, the United States should have the following objectives in mind:

A. With respect to the China differential controls:

- 1. To retain substantial control in terms of the coverage of listed items;
- 2. To continue to apply effective bunkering and voyage licensing controls to the differential area;
- 3. To tighten the CHINCOM exceptions procedures and practices (including implementation of procedures already agreed);

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4. To achieve a clearer and firmer undertaking through COCOM to deny or strictly control to Eastern Europe items which

(a) *for action* are being obtained by Eastern Europe from the Free World and then diverted to Communist China, *or*

(b) are being exported by Eastern Europe to China from indigenous production which are then replaced by imports from the West. ^{1/}

((b) to obtain agreement for multilateral consideration of measures that might be undertaken to avoid frustration of the China controls through the replacement by import from the Free World of controlled items exported to Communist China out of indigenous production within the Soviet Bloc.) ^{1/}

5. Explore the possibility of obtaining agreement by CG to deny certain materials to the Sino-Soviet Bloc where it is apparent that the Sino-Soviet Bloc is using such materials, equivalent items or materials produced therefrom for economic penetration of Free World countries; whether or not the goods are classified as strategic. ^{2/}

B. With respect to COCOM controls:

1. To oppose any relaxation of COCOM controls;
2. To achieve embargo of copper wire;

^{1/} Bracketed material is supported by Commerce, Defense and Treasury. Parenthetical language is suggested by State, MMAC and ICA as a substitution for the bracketed material.

^{2/} Recommended for inclusion by Defense and Commerce.

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3. To obtain acceptance of improved controls over the sale, transfer and repair of merchant vessels;
4. To achieve improved quantitative control (specific proposals would be prepared in advance of the CG meeting);
5. To seek improvement of reporting procedures and possible establishment of "peril points" or other similar techniques for IL-III items;

C. With respect to general CG/COCOM/CHINCOM considerations:

1. To work towards a closer alignment with NATO;
2. To achieve agreement for periodic consideration of the trade trends and tactics of the Sino-Soviet Bloc, particularly in light of recent economic penetration efforts by the Bloc.

VII. Analysis of the Relative Strategic-Economic Importance of the Differential Lists

Annex D arranges all the China control items, plus those items on IL-II and IL-III which had been nominated by the U. K. or Japanese for deletion, in three lists. List A comprises items considered to be of least relative strategic-economic importance. List B comprises items considered to be of average relative economic-strategic importance and List C comprises items of greatest relative economic-strategic importance.^{1/} In general, the bases for rating these groups were the supply position within the Sino-Soviet bloc, the complexity of the product or the equipment necessary to produce it, the relationship of an item to other items or groups of items and the relationship of military application. These methods were developed solely for this purpose and are not likely to be

1/ With few exceptions, items under differential controls are available to Communist China, either from other Bloc sources or by transshipment from the Free World. The 37 items identified by CIA are those for which the continuation of control has a most probable adverse effect on the industrial growth of Communist China.

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accepted as a basic rationale in negotiations with other countries. However, this grouping should constitute one element of negotiating guidance in any international discussions.

Annex D also arranges the items within Lists A and B in several groups. These groupings represent evaluations in addition to the strategic judgments described above. They reflect the current availability of items in the Free World, the priority for trade attached to items by Japan, and the likelihood of significant trade developing with China within the over-all estimate of probable increases in Communist China's imports from the Free World.

From the standpoint of negotiations, Defense is of the opinion that the distinction between List A and B items is of major significance, since the former could be conceded without materially affecting the aggregate impact of the China controls. The distinction between List B and C items is considered less significant since any material concessions in these areas significantly erode the controls, the only difference being one of degree.

VIII. Special Problem of Rubber

In view of the importance which the U.K., upon political considerations related to Malaya, has attached to special treatment for rubber, as well as the obvious problems, both political and economic, which face the Free World with respect to this commodity, especially in South and Southeast Asia, it would appear that, in conjunction with any reduction that might now be made of the China differential, the net interests of the Free World would be served by a reduction in the control over natural rubber. In the light of the rubber shipments which are being made to Communist China by Ceylon, as well

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as shipments in prospect by Burma and Indonesia, and in view of the fact that Communist China has been reliably reported to be re-exporting a substantial part of the rubber which it is presently purchasing from Ceylon alone, it would appear that application of a quantitative control technique to rubber would be of no practical utility. Furthermore, aside from the fact that efforts to negotiate quotas are likely to engender controversy, the employment of quantitative controls under these circumstances might subsequently prove politically embarrassing to the United States Government having been in some way consciously deceptive. It appears, rather, that Free World security interests would be better served by maintaining a close surveillance over the movement of natural rubber. This could be achieved by multilateral agreement in CHINCOM to give surveillance treatment to exports of rubber to the entire Sino-Soviet bloc and by bilateral negotiations by the United States with exporting countries where necessary to obtain their agreement to special reporting of rubber exports to the bloc. The U.K., of course, is the only CG/CHINCOM country interested in rubber exports, and therefore special negotiations concerning reporting might be necessary only with the U.K. and those countries in South or Southeast Asia who might engage in this trade.

IX. Future Reviews

With respect to the publicized U. S.-U. K. agreement to review the China controls "periodically," the U. S. position should be that the current review has been made on the basis of prevailing conditions and that it is not appropriate to schedule a further review at this time. However, the U. S. recognizes

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that conditions may change, thereby making necessary a reconsideration of the China controls; in this connection, the principle should be recognized that the review might well result in an upward revision of controls should there be a new threat of deterioration of the Far Eastern political and/or military situation.

X. Recommendations for Negotiation

With respect to the forthcoming bilateral negotiations on the level of controls against Communist China, the Departments of State, ICA, ICA/MDAC and Commerce make the following recommendations:

1. U. S. Position:

The United States is prepared:

- a. To negotiate, as an area of concession, a downrating from the CHINCOM embargo list to a surveillance list (or, to the extent it becomes necessary, to decontrol) of the 7⁴ items in List A and List B of Annex D, plus such portions of the items presently classified in List C as may, through a process of redefinition, be agreed for placement in Lists A or B, and natural rubber (with a special bilateral agreement on reporting with the U. K.); and to agree a special bilateral exceptions arrangement with Japan on wooden fishing vessels.
- b. To review CHINCOM controls whenever a change in the international situation occurs which in the view of any PC is deemed sufficient to warrant a review either for further relaxation or strengthening of controls to Communist China.

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2. At the same time, the United States should seek agreement to and support for the objectives set forth in Part VI of this report. Of particular importance therein are the desired improvements set forth in subpara-graphs A 1, 2 and 3 and B 1 and 2^{1/} (subparagraphs A 1, 3 and 4; B 1, 2 and 4; and C).^{1/} The extent to which U. S. negotiators are authorized to indicate tentative agreement in bilateral negotiations will in each case depend upon the extent to which the PC concerned accepts and undertakes to support in the CG the U. S. objectives stated above. Agreement of a PC not to exceed the down-ratings or deletions which the U. S. negotiators are authorized above is alone not sufficient to warrant U. S. acceptance of the arrangements; the COCOM/CHINCOM control system must be strengthened in return for U. S. concurrence in relaxation of CHINCOM controls. These judgments will be made initially by the negotiators, subject to inter-agency review in Washington when the results of the several bilaterals become available.⁷ 2/

3. Negotiating Procedure:

Full bilateral discussions should be undertaken by the United States with the various participating countries. A bilateral with Japan should occur first and be followed by a bilateral with the United Kingdom. Bilaterals with the other participating countries should promptly follow to assure a fuller understanding by them of the United States view, to

1/ Bracketed material is proposed by State, ICA and ICA/MDAC; parenthetical material is proposed by Commerce.

2/ The Department of Commerce recommends the inclusion of the bracketed material.

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gain support for that view and to avoid increasing present resentment regarding extensive U. S.-U. K. discussions. The results of individual bilaterals should be reported promptly. Before a final U. S. position is established for presentation to the Consultative Group, full account should be taken of such bilaterals as have been completed.

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I. Recommendations for Negotiations

6. With respect to the forthcoming negotiations on the level of international controls against Communist China, the Department of Defense ^{and Treasury} makes the following recommendations:

U.S. Position

The U.S. is prepared to offer, as an area of concession, the removal from the CHINCOM Embargo List of the 35 items in the A List of Annex D, plus rubber, wooden fishing vessels, certain iron and steel products and possibly parts of two or three items of special interest to Japan which are on the B list.

Negotiating Procedure

1. As an initial step, President Eisenhower should address a letter to Prime Minister Eden, stating in substance: that U.S. Government has reviewed the U.K. proposal to eliminate over a period of a year the differential between the COCOM and CHINCOM Control Lists and finds it impossible to go that far. The U.S. sees no basic change in the Communist position in the Far East; it considers any substantial reduction of the China controls would provide only slight advantage to the free world economic position and would be of great disadvantage to the security position of the free world. Nevertheless, the U.S. is prepared to make certain concessions (the A List items, plus rubber) in the effort to arrive at an agreed position with the U.K.

2. With the Japanese, the U.S. should continue discussions at the Foreign Office (technical) level, offering concessions on the A List items, plus certain parts of the iron and steel group (List C),

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wooden fishing vessels, and a few other parts of items of special ~~interest~~ Japanese interest.

3. If, as a result of these negotiations, it does not appear that the U.S. position can be maintained, then the U.S. should move to a consideration of items on the B List, but only if the U.K. and Japan commit themselves to strongly support the U.S. in the CG on a proposal to gradually narrow the China differential, by the process of transferring some items from the CHINCOM List to the COCOM List, and by dropping others entirely. In the initial stages of this process, only B List items would be considered. Certain items, such as copper wire and ships, should be restored to the effective COCOM control at once by virtue of their special importance. It should be agreed that the ultimate result would be a unified control program, substantially narrower in scope than the present CHINCOM controls, but substantially broader than the present COCOM controls, the entire control to be effectively implemented.]

NOTE: The foregoing bracketed material is recommended by the Department of Defense in substitution for Section X, page 11.

and Treasury

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